No. 14221.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALICE E. COHN, MARION A. COHN, DANIEL E. COHN, and EDGAR M. COHN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

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JURISDICTION OF THIS COURT.

The Petitioners are residents of the Southern District of California and duly filed their income tax returns for the calendar years 1945 and 1946 with the Collector of Internal Revenue for the Los Angeles District of California, all within the jurisdiction of this Court.

The petitions for review by this Court were filed pursuant to Sections 1141 and 1142 of the Internal Revenue Code to review the decisions made by the Tax Court of the United States (21 T. C. 11), sustaining the determination of the Respondent, who had determined defi-

ciencies for the calendar years 1945 and 1946 in the following amounts:

Alice E. Cohn	1945	$ 6,810.12
	1946	1,835.48
Marion A. Cohn	1945	$18,468.73
	1946	1,967.24
Daniel E. Cohn	1945	$23,018.25
	1946	1,198.96
Edgar M. Cohn	1945	$ 8,051.34
	1946	1,088.21

[T. 45-48].

NATURE OF THE CASE.

Petitioners Daniel E. Cohn and Edgar M. Cohn are, and were at all times herein mentioned, partners, and as such owned and operated Security Construction Company. The Security Construction Company was, at all pertinent times, engaged in the Los Angeles area in the dual trade or business of building and renting multiple family houses for investment and of building and selling single family houses. During the year 1945, Security Construction Company sold 69 apartment buildings, all of which had been rented for more than six months and had been used in its business of renting houses for income and investment purposes. For income tax purposes the partnership treated the gains so derived as gains from sales of capital assets held for more than six months. The Commissioner of Internal Revenue treated the gains as ordinary gains and determined that there were deficiencies in respect to Petitioners' income taxes for 1945 and 1946. The Tax Court sustained the Respondent in this determination, and the Petitioners filed with this Court petitions to review the decisions of the Tax Court.

STATEMENT OF FACTS.

A written stipulation was entered into by Petitioners and Respondent and filed with the Tax Court stipulating the following facts to be true:

Stipulated Facts.

1. The partnership, Security Construction Company was formed on May 21, 1942, and the partners have at all times been Edgar M. Cohn and Daniel E. Cohn. Marion A. Cohn is and was during the entire years 1945 and 1946 the wife of Edgar M. Cohn. Daniel E. Cohn and Alice E. Cohn were married June 5, 1945, and have at all times since been husband and wife. Edgar M. Cohn and Daniel E. Cohn are brothers.

2. Tract No. 13172 in the City of Los Angeles, California, was acquired by the partnership by deed dated May 25, 1942, as acreage, and was subdivided by the partnership on August 26, 1942, into 132 lots. In the latter part of 1942 and the early part of 1943 the partnership built 130 single-family residences in said tract. Twenty-one of said residences were sold in 1942 and 109 were sold in 1943. The profits on said sales were reported for Federal Income Tax purposes as ordinary income and taxes were paid on that basis.

3. Tract No. 13710 in the City of Los Angeles, California, containing 56 lots, numbered 1 to 56, inclusive, was subdivided on September 27, 1943, and the partnership acquired said subdivided tract by deed dated September 28, 1943.

4. Tract No. 13171 in the City of Los Angeles, California, containing 122 lots, numbered 1 to 122, inclusive, was subdivided on January 19, 1944, and the partnership acquired said subdivided tract by deed dated January 21, 1944.

5. The partnership constructed 56 multiple-family apartment buildings in Tract 13170, one on each of the 56 lots. Twenty-three of these were four-unit apartment buildings and 33 were two-unit apartment buildings. The buildings constructed on Tract 13170 were completed as follows:

Lot Nos.	Date Completed
24-39 inc.	2/14/44
40-56 inc.	3/ 8/44
14-23 inc.	3/28/44
1-13 inc.	4/25/44

6. In about March, 1944, the partnership commenced the construction of 13 four-unit apartment buildings and 109 single-family residences on Tract 13171. The 13 apartment buildings were completed by June 14, 1944 and the single-family residences by September 1, 1944.

7. The 109 single-family residences in Tract 13171 were sold from July to September, 1944, and the profits on said sales were reported for Federal Tax purposes as ordinary income and taxes were paid on that basis.

8. Depreciation was claimed on the said apartment buildings in the Federal Income Tax Returns filed by the partnership for the years 1944 and 1945 at the rate of 4% per annum.

9. The 69 apartment buildings referred to in paragraphs 5 and 6 above were sold during the calendar

year 1945, between January 16 and October 31, inclusive. These 69 apartment buildings were located on Lots 1 to 56, inclusive, in Tract 13170, and Lots 110 to 122, inclusive, in Tract 13171. These sales were reported by the partnership in its 1945 partnership income tax return on the installment basis, as long-term capital gains. The Commissioner has determined the profits from such sales taxable as ordinary income.

10. The partnership built two duplexes and 14 single-family residences in Pasadena. Construction of said buildings was started in about July, 1945, and the buildings were completed during the first three months of 1946, and were sold in February and March, 1946. The profits on said sales were reported for Federal Income Tax purposes as ordinary income and taxes were paid on that basis. [T. 53-55.]

At the conclusion of the trial a supplementary stipulation of facts was entered into by the parties [T. 55a to 55f], the full extent of which we do not believe necessary to set forth herein. The pertinent facts stipulated were:

Security Construction Company received gross rental income from the 69 apartment buildings in 1944 of $92,437.20 and net income from said rentals of $28,793.84 [T. 55b and c]. The Tax Court so found [T. 27]. For 1945 the gross rental income of the partnership was $45,841.07 and the net rental income was $8,425.32 [T. 55d and e]. This was also found to be true by the Tax Court [T. 30]. It was further stipulated that the partnership took depreciation on its income tax return for 1944 of $16,271.30 and for 1945 in the amount of $9,815.00, or total depreciation during the holding of

said property for rental purposes of $26,086.30. These depreciation figures also appear in the 1944 and 1945 income tax returns of the partnership [T. 110 for 1944; T. 119 for 1945].*

Facts Established by the Evidence.

Petitioner Edgar M. Cohn testified that he was in the "real estate business with the construction of buildings for sale and for investment" [T. 214] and that he had been in the real estate business since 1941 with his brother, Daniel E. Cohn [T. 214]. The partners were in constant communication with the Federal Housing Administration in 1943 to determine if priorities were available in the area of their activity, and when they learned, in the summer of 1943, that there were 1,000 units programmed in the area in which they were interested, they talked to an official of the F.H.A. concerning the building of buildings on Tract 13170 [T. 215]. They were advised by F.H.A. that in order to obtain priorities they would have to construct multiple residence buildings [T. 215-216]. On July 17, 1943, they received priorities for the building of 56 multiple residence buildings containing 158 rental units on Tract 13170 [Pet. Ex. 7; T. 72] priorities for the remaining 13 multiple dwelling buildings were granted December 17, 1943. Construction was started on the 56 buildings about October 1, 1943 [T. 216]. Construction on the 13 apartment buildings was started in about March, 1944. Construction of the 69 buildings was completed at varying stages between February 14, 1944

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*The 1945 income tax return shows depreciation on the rental property in question of $9,789.93 and the written stipulation shows it to be $9,815.00, or a difference of $25.07.

and June 14, 1944 [Stipulation of Facts]. At the time applications for these priorities were made, the partners intended to sell the buildings when completed. In the latter part of December, 1943, after having consulted with their attorney and one of the officials of the Glendale Federal Savings and Loan Association, they determined to change their purpose of holding the buildings for sale to holding them for rent and investment [T. 217-219]. As we consider the evidence on this point to be very important we set forth below the testimony establishing the said change and the reasons therefor:

(Testimony of Edgar M. Cohn):

"Q. At the time that you got the application for these priorities and started construction of those buildings, what [39] did the partnership intend to do with the buildings? A. We intended to sell the buildings.

Q. Did the time come when the partnership arrived at any other determination? A. Yes.

Q. When was that? A. December, 1943.

Q. And in December, 1943, what determination did the partnership make? A. The partnership made the determination to hold the buildings for investment and rent the apartments.

Q. Where was your brother, Daniel, at that time? A. In December, 1943, Daniel was in the Armed Forces of the United States.

Q. And you were running the partnership business? A. Yes.

Q. Your father was assisting you? A. He was advising me.

Q. All right. Did you discuss this question of holding them for investment with anyone other than your father? A. Yes.

Q. Who did you discuss it with? A. With Mr. Hollingsworth of the Glendale Federal Savings & Loan Association.

Q. When did you first discuss the matter with him? [40] A. In December, 1943." [T. 217.]

"Q. What was his advice to you? A. His advice to us was that through the medium of depreciation we would receive tax free income and could use that income to pay off the obligation that we had placed on the buildings, and thereby create an estate.

Q. Did he tell you you should hold it for investment purposes? A. Definitely, yes.

Q. Did you discuss that question with anyone else? A. With John E. Biby, our attorney.

Q. Where and when did that conversation take place, approximately? A. That conversation took place at Mr. Biby's home the last week in December of 1943.

Q. Who was present? A. My father, Max Cohn, Mr. Biby and myself.

Q. What advice did Mr. Biby give you with reference to that?

Mr. Chehock: What time was this?

Mr. Conroy: The last week of December, 1943. That is his testimony.

The Court: You may answer the question.

The Witness: He advised my father and myself to hold the buildings for investment [41].

Q. (By Mr. Conroy): Did you figure what the net income would be, with Mr. Biby? A. Yes. We had quite a discussion with Mr. Biby and we deter-

mined that the net income would be approximately $43,000.00 or $44,000.00 or approximately 12½ per cent return on the cost of the buildings." [T. 218.]

"Q. And did you talk to anyone else concerning the subject? A. Yes.

Q. Who else? A. Mr. Harold K. Wood.

Q. When did you talk to him? A. Shortly after the first of the year. I would say early in January in 1944.

Q. Where did you talk to Mr. Wood? A. At Mr. Wood's office.

Q. What discussion did you have with him concerning that subject? A. We discussed the advisability of holding the buildings for investment purposes. Mr. Wood advised us as to that fact and insisted that—

Q. Don't say 'insisted.' Tell us what he said. A. He said that I should write him a letter advising him that the partnership had decided to hold the buildings [42] for investment purposes.

Mr. Conroy: Mr. Chehock, I think you have seen a copy of this letter.

Mr. Chehock: Yes.

Q. (By Mr. Conroy): Mr. Cohn, I show you a letter dated January 12, 1944, signed by Edgar M. Cohn. Is that your signature? A. That is my signature.

Q. For what purpose was that letter written? A. It was written to advise our accountant, as per his request, that we were engaged in holding these buildings for investment purposes and to set them up on the books for that purpose." [T. 219.]

The said letter from Mr. Cohn to Mr. Wood was introduced into evidence and marked Petitioners' Exhibit 19 [T. 220-221]. Copy of said letter is as follows:

"Security Construction Company
Developers of Beautiful Glenwood
7801 Glen Oaks Boulevard
Burbank, California
STanley 7-3536

January 12, 1944.

Boyle & Wood,
Taft Building,
Hollywood, California.

Gentlemen:

We are now building fifty-six buildings consisting of thirty-three doubles and twenty-three four family dwellings in Tract 13170, City of Los Angeles, within three-quarters of a mile from Lockheed Aircraft Corporation.

During the past three years we have built 200 single family dwellings, all of which we sold and are now occupied by war workers.

After due and careful consideration, and in view of the fact that we are now engaged in building rental units, we have decided to rent all of the 158 units in the 56 buildings now under construction and hold same for investment purposes.

Respectfully yours,

Security Construction Company,
By /s/ Edgar M. Cohn,
Co-Partner."

EMC/DC
[Pet. Ex. 19; T. 220-221.]

The testimony of Radcliffe Hollingsworth, vice-president of Glendale Federal Savings & Loan Association, who had been connected with that organization for 17 years [T. 236], with reference to the determination of the Cohns to hold the buildings for rental, was as follows on direct examination:

"Q. Mr. Hollingsworth, did you ever discuss with Mr. Edgar Cohn and his father, Max Cohn, in the year 1943, the question of holding the multiple houses in those tracts for investment purposes? A. Subsequent to the application for the priorities, which of course was out of our hands—the priorities had to be obtained by the contractors themselves. Once having received the priorities, they were in a position to request commitments from the Federal Housing Administration for the purposes of building the structures involved.

At the very inception it was my advice that, through the medium of depreciation, it would be possible to build up an estate through the utilization of that nontaxable income derived. At that particular time I made figures and calculations predicated on the depreciation that was allowable, and that proved conclusively that by the utilization of that [59] method, they would ultimately own the property free and clear, paid with nontaxable income.

Q. Did you advise them to hold it? A. I did.

Q. When was that? A. In 1943. It was prior to the recording of those instruments. I don't remember the dates now.

Q. Did you have more than one conversation with Mr. Edgar Cohn and his father concerning the subject? A. I had many conversations with them.

Q. Did the time come in 1943 when they discussed with you that subject and stated they were

going to hold them? A. Ultimately, they came to the conclusion that that was the process to follow.

Q. Did they tell you that? A. They told me that.

Q. When? A. That is when the buildings were in the course of construction. I don't remember the date.

Q. You wouldn't remember the date or the year? A. No. No buildings were completed at that time." [T. 237-238.]

On cross-examination, he testified:

"Q. Now, regarding this conversation you had, to whom did you talk? A. I talked to Dan, Edgar and Max. Dan subsequently went into the Service, but subsequent to his going into the Service, I constantly talked to Max and Edgar as they were on the tract and I would drop over there a couple of times a week.

Q. In your conversation with them regarding whether they should hold this for investment or for sale, was the [62] matter of tax saving mentioned? A. In connection with the whole transaction was the utilization of depreciation for the purpose of building up an estate. Tax saving entered into the picture.

Q. I don't think you understood the question. Was tax saving mentioned at the time of the conversation as one of the reasons for your suggesting that they hold them as investment property? A. Yes.

Q. Do you remember what your conversation was to them about what the tax saving might be? A. The calculation I made gave evidence of the fact that by following the procedure which I had outlined, that by that process they would liquidate their entire

obligation with tax-free money and build up an estate by virtue of so utilizing that procedure.

Q. You say by liquidating their assets. Do you mean they could later sell them? A. They could hold them forever, but they could do the amortization through the medium of depreciation and apply it against the obligation and ultimately pay off the entire transaction and build for them an estate.

Q. Was there some mention that they be held over as a long-term capital gain? A. The whole idea was to build an estate [63].

Q. *Was there any conversation at all that they might later want to sell them? A. No.*

Q. Isn't it true that these multiple houses were originally built to sell? A. Not to my knowledge. They were built to rent or sell. They had to rent them at that particular time. *Due to the fact that they had to rent them. I suggested that they continue to rent them."* [T. 240-242.]

Harold K. Wood, certified public accountant for the partnership Security Construction Company and partners was called as a witness and testified with reference to the determination of the partners to hold the property for investment purposes as follows:

"A. Edgar came in to see me that particular day to discuss the multiple apartment buildings which they had under construction. He stated to me that under the requirements of the National Housing Agency they were required to rent them for a limited period. He said they had been considering what the effect of that requirement would be and they had projected what the rental use might be expected to show if they held them, themselves.

He told me that he had discussed that, himself and his father, with Mr. John Biby, who, at that time, was their attorney. He said as the result of their projection and investigation they had decided that the buildings would make a good investment for them to hold. He told me that they [187] had decided not to sell the buildings, not to offer them for sale, but to hold them for investment.

Q. What did you say? A. I accepted the information and made notes on it and then asked them if they had considered what the effect on the over-all picture would be on income taxes. His statement to me was, 'No, we don't intend to sell them. We are going to keep them for investment.'

I said to him, 'If you don't intend to sell them, something may happen in the future which may cause you to sell them anyway.' And I explained the provisions of 117-J and explained that the capital gains provisions in Section 117-J did not apply to property held primarily for sale to customers in the ordinary course of business.

I advised that I wished a written letter from him stating that they had determined to hold the buildings for investment so that there would be no question about it in the future if sale occurred." [T. 349-350.]

The letter requested by Mr. Wood is Petitioners' Exhibit 19 and is heretofore set forth in full in this Statement of Facts.

Prior to August 25, 1943, the applicable Federal regulations prohibited the sale of a dwelling unit in a private war housing project to an occupant until the expiration of four months' continuous occupancy [Resp. Ex. P, N.H.A. Order No. 60-3, Sec. 3a, effective 2-5-43, T.

175-177]. Section 3b of the regulation further provided that such housing could be sold to persons other than occupants [T. 178]. N.H.A. Order No. 60-3B, Section 3a(i) effective August 25, 1943, amended the previous regulation by shortening the time of occupancy to two months to qualify an occupant to purchase such housing [Resp. Ex. 2, T. 184-186]. When completed, the buildings were rented on written leases. A copy of the typical form of lease used was received in evidence as Petitioners' Exhibit 18 [T. 210]. The leases were for a term of one year, with automatic renewals for an additional year at the expiration of each year. In that connection, the lease provided as follows:

> "To have and to hold: The above described premises, with appurtenances, unto said party of the second part, from the 1st day of May, 1944, to the 30th day of April, A. D., 1945, at 12:00 o'clock noon, provided sixty days' written notice is given Lessor by Lessee of Lessee's intention to terminate this lease on said last mentioned date, otherwise this lease shall continue from year to year until terminated by like notice in some ensuing year. Lessor is entitled to terminate this lease upon like notice to Lessee at like dates." [T. 210.]

On cross-examination, Edgar M. Cohn testified with reference to the reason for entering into leases as follows:

> "Q. As I understand it, you entered into one-year written leases, is that right? A. Yes.
>
> Q. On the 69 apartment houses? A. Yes.
>
> Q. Why did you enter into one-year written leases? A. *Because we were holding the properties for investment and would hold them indefinitely.*" [T. 254.]

Until the end of 1944, when a tenant moved, the new tenant signed a similar type of lease for a one year term [T. 307]. There was introduced into evidence as Petitioners' Exhibit 16 [T. 104] a schedule of the apartments upon which one-year leases were cancelled and the apartments rerented. The schedule shows the days of rent lost and gained during the entire period that the partnership owned the 69 buildings. A computation of these figures shows that in the rental of the 210 rental units in the 69 buildings, there were only 103 net rental days lost. This corroborates Edgar Cohn's testimony that the buildings had an average occupancy of 99½% at all times [T. 317].

Edgar M. Cohn testified that he had one secretary helping him with reference to operating the rental business and one secretary with reference to conducting the building business [T. 309]. The one girl took care of nothing but rentals [T. 318].

During the time that the buildings were being constructed, the Petitioners had many opportunities to sell them [T. 221]. Edgar M. Cohn testified that the opportunities were "almost daily" [T. 223]. After the buildings had been constructed and occupied for a period of two months, which was the minimum period of time that they had to be rented before being sold to tenants, the Petitioners had frequent opportunities to sell the buildings and refused to do so [T. 223].

In the latter part of December, 1944, the Petitioners received information that World War II was nearing an

end and that Lockheed Aircraft would discharge all but about ten per cent of their employees, causing the apartment buildings to become 50% vacant [T. 224]. At that time it was estimated that Lockheed had approximately 100,000 employees, which would mean, from the information the Petitioners then had at hand, that Lockheed would discharge approximately 90,000 employees [T. 224]. Over three-fourths of the tenants in the 69 buildings were Lockheed employees [T. 225]. The buildings were situated about three-fourths of a mile from the Lockheed Aircraft plant [T. 225].

Edgar M. Cohn discussed the problem with the Petitioners' attorney, Mr. John Biby, and after giving consideration to the serious problem involved, determined to sell said buildings [T. 224].

At the time the Petitioners determined to hold the property for investment, they did not anticipate the said sudden change in the aviation program. It was their information, that civil aviation and peacetime industry would take up the slack. Edgar M. Cohn testified:

> "Q. (By Mr. Chehock): In January, 1944, is it not true, Edgar, that you knew that sooner or later the very thing that did happen in December, 1944, was going to happen, or at least you had reasonable grounds to believe it would? A. Not in the order in which it happened.
>
> Q. At least you knew those events were probably coming? A. Not immediately or even in the near future.

Q. Irrespective of when they might come, you knew they were coming in the future? A. I didn't know [80].

Q. I beg your pardon? A. I didn't know.

Q. Didn't you have reason to feel that when the cessation of hostilities would come about, that Lockheed would discharge most of its employees? A. No.

Q. Why did you know that in December if you wouldn't have known it earlier? A. *There was talk of a civil aviation program after the cessation of hostilities and the building up of a peace-time industry in the Burbank area. We based our reasoning on that logic."* [T. 256-257.]

After the Petitioners had determined to liquidate their investment in the said 69 rental buildings, they listed them for sale with real estate brokers in January, 1945 [T. 225]. The properties were listed for a net selling price, as shown in Respondent's Exhibit S [T. 201].

In the sale of the single-family residences which the Petitioners built for sale, the partnership, Security Construction Company, employed a real estate broker to devote his exclusive time to the sale of said houses [T. 226; Pet. Ex. 20; T. 227]. The apartment buildings which were sold by the independent brokers were not advertised by the partnership [T. 229]. The Security Construction Company paid for the advertising with reference to sales of the single-family homes which were built for sale [T. 229]. The Petitioners had no single-

family houses for sale in 1945 [T. 274]. The income tax return of Security Construction Company [Resp. Ex. C] shows that the partnership spent $902.75 for advertising in 1944 [T. 352]. In 1945, the year in which the apartment buildings were sold, Security Construction Company spent $34.66 in advertising [T. 352]. The Petitioners did not supervise the activities of the brokers who sold the apartment buildings and did not assist the brokers in selling said buildings [T. 280]. None of the apartment buildings was sold to a tenant [T. 305].

During the years in question, and up to the time of the trial, the Petitioners Daniel E. Cohn and Edgar M. Cohn were engaged in the dual business of building properties for investment and building properties for sale. [T. 328-346].

The Petitioners Daniel E. Cohn and Edgar M. Cohn organized a corporation known as "Orange Gardens" in April, 1947 [T. 328], and were its sole shareholders [T. 321-322]. Orange Gardens constructed 11 multiple-type buildings in North Long Beach, California, which were completed in March and April, 1948 [T. 328]. They were immediately put on the market for rental and have been rented ever since [T. 328]. The Court found that the buildings are still held for rental [T. 32].

SPECIFICATION OF ERROR.

Petitioners' Specifications of Error Are Set Forth Preceding the Several Subdivisions of the Argument Which Follow.

ARGUMENT.

I.

The Tax Court's Decisions Are Founded Upon the Mistaken Concept and Interpretation of Section 117(j) of the Internal Revenue Code. The Interpretation of the Tax Court Does Violence to the Intent and Purpose of Congress in Enacting That Section in That It Treats a Decision of a Taxpayer to Sell His Property, Held for Investment, as Constituting a Change of Purpose From Holding for Rental and Investment to Holding for Sale.

Section 117(j) of the Internal Revenue Code, so far as material here, provides:

> "(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1) held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. * * *"

In *Allbright v. United States* (C. C. 8), 173 F. 2d 339, 344, the Court, in referring to Section 117(j) of the Internal Revenue Code and its broad application, said:

> "Nothing in the language of the Act indicates an intention on the part of Congress to deny the relief granted by the section to any taxpayer whose transactions meet the prescribed conditions."

The evidence in the record and which has been set forth in the statement of facts demonstrates that Petitioners Daniel and Edgar Cohn were, during the time in question, engaged in the business of building residential properties for sale immediately upon completion, *and in building residential multiple dwellings for rental and investment purposes* [T. 214 and 217].

In one of its latest decisions the Tax Court has recognized the proposition that a dealer in real estate may sell a defense housing project and receive capital gains treatment. In this connection the Tax Court in *Walter R. Crabtree, et al. v. Commissioner* (July 22, 1953, 20 T. C. 841), said:

> "In the instant case, to reach the conclusion for which Respondent contends would be tantamount to saying that a dealer in real estate could never sell *a defense housing project* and be accorded capital-gains treatment to such profits as may arise therefrom. *To so hold would be a clear usurpation of the legislative prerogative, for nowhere does Respondent point to, nor can we find, any evidence of Congressional intent to treat dealers in real estate who sell investment property differently from dealers of any other sort.*" (Italics ours.)

The *Crabtree* case involved a situation where the taxpayers had sold 33 housing units of a defense housing

project early in 1946, and in 1948 they sold the 3 remaining houses of the defense housing project. All of these were reported on a capital gains basis. The Commissioner determined that the gains were subject to treatment as ordinary income, and the Tax Court held that this determination was erroneous.

The evidence in these cases referred to and quoted in the Statement of Facts establishes without contradiction that the properties involved were held for investment for more than one year and were investment properties within the meaning of Section 117(j). The fact that a time came when it was determined by Petitioners, upon sound business reasoning, that the holding of said properties for rental by Petitioners would be hazardous and their original intention of permanently holding them was thereby thwarted does not deprive Petitioners of the benefits of capital gains treatment. In *Alamo Broadcasting Company,* 15 T. C. 434, 451, the Tax Court said:

> "We have previously held that 'used in the trade or business' means 'DEVOTED TO THE TRADE OR BUSINESS' and includes property purchased with a view to its future use in the business, EVEN THOUGH THIS PURPOSE IS LATER THWARTED BY CIRCUMSTANCES BEYOND THE TAXPAYER'S CONTROL. *Carter-Colton Cigar Co.,* 9 T. C. 219. See also *Wilson Line, Inc.,* 8 T. C. 394; *Kittredge v. Commissioner,* 88 Fed. (2d) 632; *Yellow Cab Co. of Pittsburgh v. Driscoll,* 24 F. Supp. 993; *Independent Brick Co.,* 11 B. T. A. 862."

It would be difficult to perceive evidence more convincing than that contained in this record of unexpected happenings which *thwarted* an investor's original purpose. The evidence shows that over three-fourths of the occupants

of the apartments were employed by Lockheed Aircraft [T. 225]. In late 1944 the Petitioner, Edgar Cohn, received information that there would soon be cancellations of war contracts and upon the ceasing of hostilities Lockheed would lay off all but about 10% of its employees. We quote Mr. Cohn's testimony as follows:

> "Q. And what was your reason or the reason that you had for changing, for determining to sell the buildings? A. There were rumors that the cessation of hostilities would be in the near future and that Lockheed Aircraft would discharge all but about 10 per cent of their employees and our apartment buildings, *in our estimation, would have a 50 per cent vacancy factor.*
>
> After consultation with Mr. Biby, we decided to sell our assets.
>
> Q. You mean these particular assets? A. These particular assets.
>
> Q. Do you know how many employees Lockheed had? A. I did not know at that time. My estimate was 100,000."

At the time the buildings were built and the determination was made to hold them for investment purposes, the information was that at the end of hostilities there would be a large civil aeronautical development which would maintain the aviation industry [T. 257].

The decision to liquidate the investment was motivated by good business judgment based upon the facts as they then appeared. It was this decision on the part of the Petitioners that the Tax Court construed to be a change of purpose. In this connection the Court said:

> "Our conclusion, based upon the findings and ultimate findings is that the 69 multiple houses were

> held primarily for sale to customers in the ordinary course of the partnership's business of building and selling houses during 1944 *and 1945, and at least during 1945, when they were sold,* and that they were not at any time 'investment' property—capital assets of a business of renting property for investment." [T. 37.] (Italics ours.)

The italicized portions of the above quotation would indicate that even though the Tax Court might concede that the property was held for investment, and not for sale, during 1944, it really made no difference for what purpose the property was held in 1944 in view of the fact that Petitioners had determined to sell and did sell the property in 1945.

This holding by the Tax Court is contrary to the holding in *McGah v. Commissioner,* 193 F. 2d 662, wherein the Court said:

> "The Tax Court found that, at the time of their sale, the 14 houses were held by petitioners primarily for sale to customers in the ordinary course of petitioners' trade or business. There was, however, no finding as to whether the 14 houses were so held prior to their sale, or as to when and how long, if at all, the 14 houses were so held prior to their sale. Such findings should be made."

There is no evidence to support the determination of the Tax Court that the Petitioners were holding the 69 multiple buildings for sale in the ordinary course of their business of building and selling properties, and without such evidence, the Court of Appeals will draw its own inferences from the undisputed facts. In *McGah v. Com-*

missioner of Internal Revenue, 210 F. 2d 769, the Court said:

> "Petitioner urges that there is no substantial evidence to support such a finding. While giving careful consideration to the finding of the Tax Court, *we draw our own inferences from undisputed facts.*"

In *Victory Housing No. 2, Inc. v. Commissioner,* 18 T. C. 466, the Tax Court determined that the property involved was the type that was subject to depreciation, but that nevertheless in the year in which the property was sold the purpose of holding for investment was changed to holding for sale. Judge Murdock, of the Tax Court, in dissenting, said:

> "A decision of the owner to sell must necessarily precede every sale *and after he makes that decision he is holding the property for sale until he succeeds in selling it.*" (Italics ours.)

When the case reached the Court of Appeals, *Victory Housing No. 2, Inc. v. Commissioner,* 205 F. 2d 371, the Tax Court was reversed, and the reasoning of Judge Murdock as set forth in his dissent is supported by the Court of Appeals as follows:

> "The fact that 42 units were sold over a period of six months does not establish a real estate business or the sale of property in the ordinary course of such a business. If a farmer has twenty separate farms which he uses in his farming business and, desiring to quit farming and to dispose of his holdings, sells them in the course of three or four weeks, or three or four months, the fact that there are a considerable number of sales in a relatively short time standing alone is not sufficient to put him in the business of

selling farms in the ordinary course of such a business. The same must be said with respect to these 42 units."

The following also supports the above interpretation of Section 117(j). *The Tax Fortnighter,* Vol. 1, p. 118:

"If a decision to sell is to be the controlling fact in determining whether or not Sec. 117(j) is to apply, the whole section might just as well be ignored."

II.

The Uncontradicted Evidence and Facts, Together With the Inferences to Be Drawn Therefrom, Establish That the Subject Property Was Held by Petitioners for Investment and the Tax Court Erred in Not so Holding.

1. The priorities granted to Petitioners by the Government required them to rent the subject properties, although they could have at any time sold them to other investors. No sales could be made to the occupants within certain specified times. In support of the proposition that this is a circumstance to be considered by the Court in determining whether the properties were held for rental and not for sale, the Tax Court, in *Julia K. Robertson, et al. v. Commissioner,* 8 T. C. M. 870, said:

"Sales could only be made under authorization of the National Housing Agency to occupants after four months continuous occupancy and at prices prescribed, etc.

"*Unless without evidence we are to impeach the good faith of petitioner's contract with these government agencies, the housing units in question were*

> *acquired by petitioner for rental purposes and not primarily for sale* to customers in the ordinary course of a trade or business. Furthermore, petitioner's testimony that such was his purpose in acquiring the properties is corroborated by the use to which the properties were devoted in the taxable years. In those years they were devoted primarily to rental, not to sales." (Italics ours.)

2. Mr. Hollingsworth, vice-president of Glendale Federal Savings and Loan Association, advised Petitioner to hold the property for investment purposes for the reason that the properties would pay for themselves with tax-free depreciation money [T. 237, 238]. His reasoning and advice are supported by the partnership income tax returns, and the Supplementary Stipulation of Facts [T. 55a to 55f]. This advice by Mr. Hollingsworth was concurred in by Mr. John E. Biby, attorney for Petitioners [T. 218].

3. Upon the determination to hold the properties for investment, a proper recording of that fact was given in writing by Petitioners to their accountant, Harold K. Wood [T. 219-220; Pet. Ex. 19].

4. Petitioners entered into one-year written leases on all of the rental properties when renting, which leases provided for an automatic renewal from year to year unless terminated by either the landlord or tenant [T. 210-211]. In *Louis Rubino, et al. v. Commissioner,* 8 T. C. M. 1095, the Tax Court held:

> "It would seem that under these conditions if petitioner had been in the business of renting homes, he

> would have leased them for long periods of time. Certainly this fact is *strong evidence* that he wished to keep his property easily available for sale, or, in other words, that he was holding it primarily to sell."

If evidence of a month-to-month renting is *"strong evidence"* that the taxpayers in that case were holding the property for sale, it would seem that a lease such as Petitioners entered into would be *"strong evidence"* that they wished to keep their property for investment.

6. The partnership segregated its rental business from its business of selling single family houses. Edgar Cohn testified he had one secretary helping him with reference to operating the rental business and he had one secretary with reference to conducting the building business [T. 309].

7. At the time the buildings were under construction and nearing completion, and after they were completed, the Petitioners had frequent opportunities to sell the buildings and refused to sell them [T. 222-223].

8. The real estate brokers selling the single family residences of Petitioners worked under the direct supervision of Petitioners [T. 226], while the brokers who sold the apartment buildings which were held for investment worked independently of Petitioners, and all that Petitioners did was to sign the necessary documents [T. 280].

9. The apartment buildings were held for rental from 9 to 20 months, or an average period of between 12 and 14 months [T. 29].

10. None of the apartment buildings was sold to a tenant [T. 305].

11. The investment was a good one in that the net rental income from the apartment buildings for the period held for investment purposes, before depreciation, was $63,305.46, and after depreciation was $37,219.16 [T. 55a to 55f].

12. Shortly after the sale of the said 69 apartment buildings the Petitioners reinvested in Orange Gardens, a large housing project, and they continue to hold that investment [T. 32 and 328].

The foregoing facts are uncontradicted and one or more of such facts have usually supported favorable treatment of a taxpayer in "117(j)" cases. It would seem from the authorities cited and particularly *McGah v. Commissioner,* 193 F. 2d 662 and 210 F. 2d 769; Victory *Housing v. Commissioner* 205 F. 2d 371; *Robert Dillion v. Commissioner,* ..... F. 2d ..... (not yet reported). That the existence of all of these facts in combination should lead to only one logical conclusion, namely, that the petitioners were entitled to be taxed on the sale of said investment properties on a capital gains basis.

III.

The Frequency and Continuity of Sales by Petitioners in Liquidating Their Rental Housing Is Not Controlling, and There Is Nothing in Section 117(j) Which States or Implies That the Section Should Apply Only to Those Who Have Few and Infrequent Transactions.

The Tax Court held:

> "There were, in 1945, the frequency, continuity, and substantiality of sales usually indicative of holding property primarily for sale." [T. 41.]

The following are cases of the Tax Court and Court of Appeals wherein sales were frequent and continuous of residential property including war housing property which had been held for rental by the taxpayers and in which the taxpayers received the benefit of capital gains treatment:

Elgin Building Corporation, 8 T. C. M. 114, 26 rental units sold in 1944 and 47 rental units sold in 1945;

Nelson A. Farry v. Commissioner, 13 T. C. 8, 9, 19 properties sold in 1944 and 27 in 1945;

McGah v. Commissioner, 193 F. 2d 662, in a 3 months' period in 1944 the taxpayers in that case sold 14 houses. It was found and determined in that case that the taxpayers were at all pertinent times engaged in the business of building houses for sale and building them for rent. During 1943 and 1944 the taxpayers built 84 single houses and 32 four-family apartment houses, or a total of 212 dwelling units, all of which were rented on a month-to-month tenancy upon completion. From April 10 to June 30,

1946, 42 single-family houses were sold, and from July 6, 1946, to October 1, 1946, 42 single-family houses were sold;

Lewis and Lamberth v. Commissioner, 11 T. C. M. 80 (consolidated cases), taxpayers Lewis sold 28 war housing duplexes in 1945. Lamberth sold 20½ war housing duplex houses in the same year. The 77 dwelling units sold in the one year were accorded capital gains treatment by the Tax Court;

Delsing v. United States, 186 F. 2d 59, in the 3 months of August, October, and December, 1945, the taxpayer sold approximately 12 war housing rental units;

Roy L. Self, et al. v. Commissioner, 9 T. C. M. 421, taxpayer sold 13 single family war houses in a 5 months period;

Walter R. Crabtree v. Commissioner, 20 T. C. 120, taxpayers sold 16 war housing units in 1944, 33 in early 1946, and the remaining 3 in 1948. According to the Tax Court: "Substantially all of the units were sold within a short period of time . . .";

Victory Housing No. 2 v. Commissioner, 205 F. 2d 371, 42 war housing units sold in period of 6 months.

The following are some of the cases involving sales of personal property which were afforded capital gains treatment:

A. Benetti Co., 13 T. C. 1072, 93 units of personal property sold in 1943, 135 sold in 1944, and 27 in 1945;

Mary Alice Browning, 9 T. C. M. 1061, 24 pieces of rental equipment sold in 1944 and 32 pieces of rental equipment sold in 1945.

The Petitioners' reasons for liquidating their investment were good ones. They of course could have faced the possibility of losing half of their tenants through the discharge of employees by Lockheed Aircraft, and had this occurred their operations, which up to that time had been very profitable, would have become a catastrophic loss operation. To hold that an investor must take the risk of operating at a ruinous loss or be deprived of the benefits of Section 117(j) would appear to us to be an illogical and improper interpretation of that section. American investors have spent substantial sums of money in subscribing to various investment advisory publications and paying fees to investment counsellors. With changing conditions, what is today a sound investment may next year be anything but a good investment. The usual procedure of the investor is to liquidate or change his investments when he believes that he will suffer a depreciation or loss by holding such property. The latest case by the Court of Appeals, which we believe is directly in point and supports the proposition that the liquidation by the Petitioners of their investment did not subject the profits from such liquidation to tax on an ordinary basis is *Robert W. Dillon v. Commissioner,* ..... F. 2d ..... (C. C. A. 8, June 4, 1954) (not yet reported). In that case the taxpayer built 20 defense houses in 1944 and 1945, and after the restrictions on the sale and rental of defense housing were removed in October, 1945, the taxpayer determined to sell the 20 houses *"because he thought it was no longer economically sound to keep them."* The houses were sold in 1946, and the Tax Court determined that they were held primarily for sale to customers in the ordinary course of his business and the gains were taxable as ordinary income. In commenting on and reversing this holding, the Court of Appeals said:

"The Court arrives at its conclusion on this point by a consideration of the business done in the taxable year 1946, *and attaches no significance to the resolution of the taxpayer to liquidate his holdings in the houses in the fall of 1945.* The Court cites one of its own opinions only to support its theory. Strictly applying this rule had the taxpayer decided to liquidate his holdings in December, 1945, and failed to complete the liquidation before January, 1946, the result would have been the same. Neither a statute nor the decision of any court is cited to support the theory of the Tax Court. *We think the principle applied is neither legal nor reasonable, but that it is clearly erroneous.* Under the evidence here the petitioner was not in the real estate business in Omaha in 1946. He was liquidating his ownership of 20 houses through a corporation engaged in the real estate business. *There is no conflict in the evidence on this decisive point.*" (Italics ours.)

If the determination of the Tax Court is to be followed it would require that Section 117(j) be construed to mean that if the owner of a large number of investment properties determines to liquidate for good and impelling reasons he would be deprived of the benefits of that Section while the owner of only one or a very few properties would receive its benefits. There is nothing in the Section which expresses or implies that the number of sales has anything to do with its application. We believe that the construction of the Section placed thereon in the cases of *McGah v. Commissioner,* 193 F. 2d 662; *McGah v. Commissioner,* 210 F. 2d 769; *Victory Housing v. Commissioner,* 205 F. 2d 371; and *Robert Dillon v. Commissioner,* ..... F. 2d ..... (C. C. A. 8, June 4, 1954, not yet reported), is a proper one.

IV.

The Ratio of Income From Sales and Income From Investment Property Is Not Controlling in Determining Whether Petitioners Were Entitled to Capital Gains on the 69 Apartment Buildings.

The Tax Court, in its opinion, said:

> "It is observed, also, that the total net profit realized upon the sales of the 69 houses in 1945, based on sales prices was $238,329, more than 6 times the net rentals received in 1944, $28,793." [T. 41.]

It was stipulated that the net income from the subject properties during the time same were rented was $63,-305.46 before depreciation, and after depreciation the net income was $37,219.16 [Supplementary Stipulation of Facts, T. 55a to 55f].

It was further stipulated by the parties, and the Court found that the 69 apartment buildings were completed on the following dates:

"Tract 13170	Completion Date
16 multiples completed by	2/14/44
17 multiples completed by	3/ 8/44
10 multiples completed by	3/28/44
13 multiples completed by	4/25/44
56	
Tract 13171	
13 multiples completed by	6/14/44."

[T. 26 and 54.]

The Tax Court further found:

> "The 69 multiple unit houses were rented, prior to the sales, for a period of 12 to 14 months, on an average. The shortest period any house was rented before a sale, was about 9 months; and the longest period any house was rented was about 20 months." [T. 29.]

An analysis of the foregoing would establish that the properties were rented on an average of approximately 9 months during the year 1944, and for income purposes one month could be added by reason of the fact that the last month's rent was paid in advance. The point that we want to make is that the substantial net income supports the proposition that the investment of Petitioners was a good one, and further supports the validity of the advice received by Petitioners at the time they determined to hold the buildings for investment purposes. Taking the Tax Court's own formula that the rental income in the part of 1944 that the buildings were rented was six times less than the profits realized from the sale of the buildings, we come up with the result that the Petitioners had a net income from rentals of approximately 20% if the rental period were extended the full 12 months of that year. We do not believe that the ratio of income from rentals and income from sales should be considered as controlling, unless possibly the properties held for income tax purposes are unprofitable. The Court, in *Delsing v. United States,* 186 F. 2d 59, held:

> "The disparity between income from sales and from rentals is not controlling."

The *Delsing* case involved the question of whether profits from the sale of 12½ duplex dwelling units should be treated as capital gains or ordinary income. The taxpayer for several years prior to World War II had been engaged in a substantial business of construction of homes for sale. As a result of solicitation by the Federal Housing Administration to provide defense rental housing, taxpayer constructed 45 defense rental units, and he was required to rent them at fixed monthly rentals to persons engaged in war activities. The housing was rented until August, 1945, when he commenced selling them. The taxpayer was associated in the business of building and selling houses from 1942 to 1945, and during that time built 273 defense housing units.

In reversing the lower court, the Court of Appeals held:

> "We think the transactions evidenced the sale of capital assets and that, accordingly the judgment must be, and is, reversed and the cause remanded with direction to enter judgment in favor of the taxpayer for the amount of refund claimed."

V.

The Tax Court Erred in Failing to Find and Hold That Petitioners Were Engaged in the Dual Activity of Building Housing Units for Investment, as Well as Building Houses for Sale. The Fact That Petitioners Were Engaged in Such Dual Activity of Building Housing Units for Rent and Houses for Sale Does Not Deprive Them of the Capital Gains Treatment on the Profits From the Sale of the Properties in Question. Furthermore, the Evidence Conclusively Established That They Had for Many Years Held Substantial Residence Properties for Investment and Income Purposes.

The Tax Court at some length in its Findings recited the various activities of the Petitioners, Daniel and Edgar Cohn, with reference to their real estate operations [T. 32.] Petitioners have at all times conceded that Daniel and Edgar Cohn were engaged in the dual business of building houses for sale and building apartments for rental. Edgar Cohn testified:

> "I am in the real estate business, with the construction of buildings for sale *and for investment.*" [T. 14.]

Petitioners Daniel and Edgar Cohn were at all times the sole shareholders of a California corporation known as "Orange Gardens" [T. 321-322]. In 1947 the corporation constructed 11 two-story apartment buildings in North Long Beach, California [T. 32]. There were 91 apartments in the 11 buildings [T. 322]. We specifically point out the number of units in this rental project for the reason that the Tax Court's Findings with reference

to this project could be misleading. We quote from said Findings:

> "Orange Gardens was organized in 1947. In 1947 it built *11 apartments* in North Long Beach, about 7 miles from the ocean. The apartments were rented immediately and are still rented." [T. 32.]

It should be conceded that a project containing 91 apartments is a substantial one, and the fact, as found by the Court, that the buildings are still held for rental is graphic corroboration of the fact that Petitioners were and are engaged in the dual business of holding property for investment as well as building for sale.

The Tax Court and this court have held that a taxpayer may be engaged in the business of building houses for sale and building houses for investment, and that such dual activity does not deprive the taxpayer of the benefits of Section 117(j). The following cases, many of which supported our argument with reference to frequency and continuity of sales, also support that proposition.

In *Nelson A. Farry v. Commissioner,* 13 T. C. 8, 9, the Court found that the petitioner was engaged in the business of "collecting rentals for a commission, insurance, investments, *and dealing in real estate.*" Although there were 46 sales of properties by the petitioner in that case, he was accorded capital gains treatment.

In *McGah v. Commissioner,* 193 F. 2d 662, the taxpayers were determined by this court to have been engaged in the trade or business "of renting and *selling* houses in San Leandro, California."

In *Delsing v. United States,* 186 F. 2d 59, the taxpayer had been for many years prior to 1945, the year in ques-

tion, and was still engaged in the business of building houses for sale. The taxpayer built war rental housing units and in 1945 sold them. The lower court held that the profit from the sales was subject to treatment as ordinary gains. The Court of Appeals reversed the lower court. In the *Delsing* case it was established that the taxpayer had written to the Federal Housing Administration in 1942 at the time the application for the loans was made that "these houses are to be built for sale or rent . . ." In commenting upon the said quoted statement, the Court held:

> "We think the weight to be given to the statement in the letter has been overemphasized in view of the subsequent restriction embodied in the formal application and agreement under which the houses were actually built, held, and operated by the taxpayer during the period of approximately three years."

In *Julia K. Robertson, et al. v. Commissioner,* 8 T. C. M. 870, the taxpayers had been engaged for several years prior to the years in question in the business of building residence property for sale. In the months of April and December, 1944, they sold 16 war housing dwelling units. In June, 1945, they sold 4 multiple dwelling units, and from September to December, 1945, they sold 9 single houses. The Tax Court held that the taxpayers were entitled to capital gains treatment on the profit from the sale of said war housing.

In *Roy L. Self, et al. v. Commissioner,* 9 T. C. M. 421, the facts established that in 1944 and prior thereto taxpayer was engaged in the business of building and selling houses. From 1941 to 1944 he built the 13 houses which are involved and rented them. The houses were

sold during a 5-months' period from April to August, 1944, because he was then pressed for money. The profits from the sales were afforded capital gains treatment.

In *James A. Baer v. Commissioner,* 11 T. C. M. 520, taxpayers were engaged in the business of building houses for sale and of building houses for investment. They sold a number of houses which had been held for investment in the 4 years from 1943 to 1946. They were financed by long-term mortgages. Their reasons for selling were varied. Some they sold in order to construct houses in a better neighborhood. Some were sold because they were poorly planned and in order to enable them to build better planned houses. The Court stated that it made no difference whether the builder was not allowed to sell because of some government restrictions, and had to rent, or whether he merely chose to rent, so long as his primary purpose was not to sell in the ordinary course of his construction business. In concluding, the Court determined that the taxpayers were entitled to be taxed on a capital gain basis.

In *Walter R. Crabtree v. Commissioner,* 20 T. C. 120, Taxpayer Walter R. Crabtree had been a real estate broker since 1925. He had started in the subdivision business in 1927 and had engaged for many years in the building and selling of houses. He was engaged in the dual operation of building for sale and building for rental. In 1943 and 1944 he constructed war rental multiple units. In 1943, Petitioner, through another wholly owned Florida corporation, completed a group of apartment units, which he still owns and rents profitably (Orange Gardens). Taxpayer sold 16 of the war housing units in 1945; 33 in early 1946, and the remaining 3 in 1948. Rentals on the war housing units were on a month to month basis.

The Court found that "substantially all of the units were sold within a short period of time. . . ." The gains from the sale of said war housing units were determined to be capital gains.

In *Victory Housing No. 2 v. Commissioner,* 205 F. 2d 371, taxpayer sold 42 war housing units during a six months' period in 1946. The Tax Court determined that the gains were subject to being taxed as ordinary income and the Court of Appeals reversed that decision. The principals had been engaged from 1943 to 1945 in the business of building and selling houses.

If it were the law that a dealer in real estate could not at the same time be an investor in real estate, it would deprive the taxpayer engaged in the business of dealing in real estate of the opportunity of investing in the business about which he had the greatest knowledge. The foregoing cases appear to us to be conclusive in favor of the proposition that the dual activity of petitioners does not foreclose them from the benefits of Section 117(j) of the Internal Revenue Code.

Conclusion.

By reason of the uncontradicted evidence, and the authorities herein cited and particularly the recent cases of *McGah v. Commissioner, supra, Victory Housing v. Commissioner, supra,* and *Robert Dillion v. Commissioner, supra,* we believe that the decisions of the Tax Court should be reversed.

Respectfully submitted,

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